THE POLITICAL SIGNIFICANCE OF RECENT ECONOMIC THEORIES

By Simon N. Patten, Ph.D.,
Professor of Political Economy, University of Pennsylvania, Philadelphia.

An American economics is a new creation, so new, in fact, that we scarcely realize its existence. I say this not because there is in the best of American work a break with the traditions of European schools, but because the underlying premises of economic thought are brought in America into clearer light and thus both their defects and strength become visible. Progress can be made by radical breaks with the past; it can also be made by bringing into sharper contrast ideas and premises which in the earlier thought were blended into a seemingly harmonious whole, but which, after all, represented opposing modes of thought. Economists can create systems, but it is only the trend of events that decides between them. Each generation compromises oppositions or holds tenaciously to opposing systems so long as there is nothing in environing conditions that forces the isolation of two differing but temporarily harmonized principles. The recent changes in economics have been of this kind.

American conditions have developed latent oppositions that by earlier writers were smoothed over because nothing vital turned on them. The progress in American economics has set aside these compromises and built a more logical scheme of thought on fewer premises better interpreted and more logically stated. There are thus two diverging schools arising from a different emphasis of elementary principles, each with a body of theory and a program of action. Their contrasts would be of little moment if there were not also a steady shifting of public interest in directions that make the differences in economic theories correspond to differences in public policies advocated by publicists and statesmen. The road of the economist becomes the road of the people and the differences of economists are settled, not by their logic, but by the success or failure of the policy which each theory calls for.

It is in this spirit that I approach the problem of distribution which I shall try so to restate as to show its bearings on public

questions. To do this calls for a bit of history, for the two theories now contending for supremacy are stated by Adam Smith and expounded by later writers. They were compromised, however, both by Smith and his followers, so that economics seems at once on both sides of what is in reality a fundamental contrast. It is to the credit of American economists that this compromise is broken down. Much of this work has been done by Professor Clark, who has taken one element of economic thought and expanded it into a system the merit of which is superior to any that has preceded it. His premises are clear, his thought is logical and his conclusions as to public policy are equally definite. His theory of distribution is called a productivity theory, because he assumes that each share in distribution is fixed by its contribution to the production of income. What a capitalist gets, what a laborer gets or what a landlord gets depends on the productivity of each of these factors in distribution. All income is related to its service in production and its distribution is but a corollary to the laws of production. There is thus a natural justice, giving to each his share and preventing any one else from despoiling him of his just reward. This natural reward is the cost price needed to evoke the effort of production. Professor Clark thinks prices tend to this cost level, and when they do reach it the return of each producer is on a just basis.

It is plain that so simple an analysis of industrial conditions has elements of great popularity. It appeals to long-standing sentiments and to many popular instincts. But before accepting it we should see what can be said by those who oppose it and why an increasing number of economists find its premises and conclusions unsatisfactory. To do this we must contrast the productivity theory of distribution with a price theory which assumes that distribution is effected solely by price movements. In this way the elements in price become the factors in distribution instead of the agents in production, as Professor Clark assumes. Each share in distribution grows or falls off as it becomes a larger or smaller element in the price of commodities. Changes in price levels result not in a general loss or gain to all producers, but in a loss to some and a gain to others. If seven pounds of steel have been exchanged for a bushel of wheat and the ratio is so changed that six pounds of steel will buy a bushel of wheat, all farmers lose and steel makers gain;

while when eight pounds of steel must be given for a bushel of wheat, steel makers lose and farmers gain. If this be true, there is no general fall of prices following improvements in production. The gains in production constantly remain as price elements and are distributed by price changes. Values are thus put at a higher level than costs by improvements lowering the expenses of production. The difference between total values and total costs is the social surplus for which each group of producers contends. The successful in this endeavor become monopolists and get a larger share than do their less successful competitors. Monopoly is thus a natural phenomenon due to the growth of the social surplus. Its form may be changed, but it is always present and is of ever increasing importance as the productive power of men grows and their surplus is augmented.

Out of this fact arises the dilemma of modern economic thought. We instinctively feel that we ought to have a surplus over the cost of work and we also instinctively feel that others ought to work for cost prices. When we become producers we ask, "What will be the gain in this or that act of production?" thereby admitting that values are higher than costs and that each man's motive in production is the acquisition of some part of the surplus. Everyone would admit this and see nothing wrong in it, but when these same acts are passed in review as parts of public policy a standard of cost production is set up and the claim is made that cost prices are just prices. Either we are wrong as individuals to demand a gain in each act of production or we are wrong in asking that other people work for cost.

We remove this difficulty when we assume that the share of each claimant is fixed by the relative increase of his products. Years ago I stated the resulting theory of distribution as follows:

> Of the factors necessary for production, that factor which tends to increase at the slowest rate will reduce the shares of the other factors to their lowest limits, will have the benefit of all improvements and must bear all permanent burdens.

This law is merely a corollary of the law of supply and demand. Given different rates of increase of products some must go down in price until their lowest limit is reached, while others will

rise until all the free surplus is absorbed. Falling prices are due to consumers' choices, and the more nearly complete this power of choice the more must competing producers lower their prices to get a market for their goods. High prices persist where no substitutes are at hand; low prices prevail where consumers' wants can be supplied in many ways. The slowly increasing factors in distribution are therefore in the fields where the power of substitution is poorly developed, while rapidly increasing factors correspond to the fields where the power of substitution is so nearly complete that low prices dominate. Factors in distribution thus fall into two classes: growing factors where the power of substitution fails, and the limited or losing factors where this power prevails.

It should be remembered that by a growing factor is meant one that is becoming a larger element in the price of commodities. In a progressive society all factors probably get more if we measure their total receipts, but many of them may at the same time be a smaller element in price and thus have reduced relative share even when the amount of their share is greater than before. The rent of a city lot, for example, may rise from $1,000 to $5,000 a year, and yet if ten times the amount of goods is produced on the lot this rent will be a smaller part of the price of each article produced. Rent may thus be a smaller part of the total value of goods, although its total amount is greater. By growing shares are meant only those which grow both in amount and in relative importance. These growing factors are at the same time the most slowly increasing factors, for the less the rate of increase of the product is, the more rapid is the growth of the share as an element in price. They gain what the power of substitution takes from other factors who have definite claims that must be allowed, but who cannot expand them so as to get a share in the social surplus created by improvement. Growing shares are thus residual claimants who absorb all the benefits of progress.

There are thus a number of limited claims due to the fact that certain shares are subject to definite laws, and there is a residual claimant that gets what is left because other factors fail to secure it. There are also factors whose shares are falling because the power of substitution is cutting down the price at which their products are sold; and there is a growing factor which gains what the pressure of competition takes from its rivals. With the aid of

these contrasts the place of the various factors in distribution becomes evident. The residual claimant is monopoly, the growing share is wages, while the shares that are limited and tending to fall in amount as society progresses are rent, profits, interest and risk. Where the power of substitution acts against the growth of a share the only problem is: What resists a fall in prices which if effected would wipe out the share? Definite laws of rent, profits and interest have been formulated which show what the lower limits of each share is. None of these limited shares can claim a larger amount of the gross product of industry than it now receives, and against them the power of substitution will act with increasing force. These shares can therefore be said to fall off with progress and in an ideal state of society to disappear if we assume that in such a society the power of substitution is complete and the environmental conditions of men are improved to their maximum.

The growing shares as we find them to-day are plainly monopoly and wages. There is, however, this difference between them: Wages at any one moment is fixed like the other limited shares. It is not, as President Walker taught, a residual claimant. And yet it is a growing claimant which secures in the end what the other shares lose. The more productive land is, the lower will be rent; the greater the ingenuity of inventors and industrial managers, the less enduring will be their reward, and the larger the productive power of capital the less will be the rate of interest. This is because the power of substitution cuts down the return of all effective agents except labor. Through the increase of their mobility the laborers substitute better opportunities of labor for the poorer ones they formerly utilized; they go from poorer land to the better land, from worn-out regions to those with increasing fertility, from mechanical occupations to those demanding skill and efficiency. They thus move from the margin of production that yields small returns to points of higher productivity, and by wiping out the old margin set a new standard for wages and force the public to pay them. The increase of wages is measured by the laborers' mobility, and wages will be a growing share in distribution so long as this agent is active in forcing new adjustments of population and in creating a wider spread of the knowledge that makes production efficient.

The laborers' advantage, however, does not end here. Another

potent force in raising wages is the socialization of the laborers taking place in every industrial group. The differentiation of industry throws into the various industrial groups men of similar character, education and ability. Like qualities and common interests create group feeling and generate a consciousness of kind which makes socialization possible. Groups thus formed ceasing to act as individuals must be dealt with as units. They will not compete with one another for places, nor undersell each other on the market. We have thousands of industrial groups of various kinds—high and low—so fully socialized that their joint action limits individual competition and gives a monopoly power to their members. This socializing tendency is not a disappearing force, but one that is growing so rapidly that it will soon be a dominant element in industry. When this time comes, or to the degree that it comes, the influence of marginal production on prices will cease. The competition that lowers prices is that of individuals within industrial groups. Marginal production assumes individual action on the part of each producer and individual interests that stand opposed to other producers. Should this competition cease the marginal man will no longer fix prices. Each group of producers will offer its joint product as before and the law of substitution will fix its value; but there will be no test of individual productivity by which the price of labor can be forced down. The growth of wages would be limited only by the productivity of industry.

Keeping in mind the increasing mobility of laborers and the growing socialization of industrial groups, it is evident that wages will steadily rise and that a rising standard of life will permanently keep intact the gains of each generation. Wants grow faster than productive power, creating an irresistible pressure that no other force can withstand. The power of monopoly, on the contrary, is temporary; each particular monopoly gains the ascendency at the expense of some other monopoly. The losses from new monopolies never fall on the public,—they are borne by those who have lost the old powers that gave them a monopoly force. Monopoly temporarily increases with every improvement in production, but these gains soon fall away unless they are reinforced by those coming from the new improvements of industrial processes. Rapid progress means much monopoly; slow progress means its decay, and static conditions would lead to its disappearance. That industrial mo-

nopoly is more frequent and powerful than a century ago is the cost of rapid progress. Monopoly is the index of change and a sign of an increasing social surplus. It means no perversion of industrial forces, and is as natural a result as are any of the other phenomena of distribution.

Such is in outline the price theory of distribution with its corollary that industrial monopoly is a natural result of price movements. Is it correct, or is Professor Clark right in asserting that monopoly is "a general perverter of the industrial system"? The answer to this question constitutes the essential difference between the two theories of distribution that I have presented. Both theories also have definite consequences which have been clearly stated in recent discussions. Professor Clark's "Essentials of Economic Theory" gives a clear program that logically follows from the acceptance of the productivity theory and its corollary that cost prices are just prices. In my "New Basis of Civilization" I have outlined a program that seems to follow just as logically from the acceptance of the price theory of distribution.

The essence of Professor Clark's position is the belief that cost prices are just prices. Producers should get a fair return on their capital and no more. This doctrine is the basis of economic theories so well established that it has become a part of the popular consciousness. The difference in Professor Clark's view and that of earlier writers consists in the fact that he regards monopoly as an evil so powerful that if not destroyed the régime of natural prices will cease. Earlier writers believed that economic motives active in individuals would suffice to keep prices on a cost basis. He demands a regulation of monopolies. "It is perfectly safe to assert," he tells us, "that only by new and untried modes of asserting the sovereignty of the state can industry hereafter be in any sense natural, rewarding labor as it should, insuring progress, and holding before the eyes of all classes the prospect of a bright and assured future."[1] "Monopoly is not a mere bit of friction which interferes with the perfect working of economic laws. It is a definite perversion of the laws themselves. It is one thing to obstruct a force and another to supplant it and introduce a different one; and this is what monopoly would do. We have inquired whether it is necessary to let monopoly have its way, and have been able to

[1]Essentials of Economics, p. 379.

answer the question with a decided *No*. It grows up in consequence of certain practices which an efficient government can stop."[2]

No one who accepts Professor Clark's principles can dissent from his conclusion. Monopoly will not disappear by any force that individuals can put in action. If the tendency of prices to rise above the cost level is wrong, he is a bad citizen who benefits by the higher range of prices. The control of prices thus becomes the first duty of the state to which its older function of securing justice and fair dealings becomes subordinate. In these views Professor Clark does not stand alone. He represents the great mass of American citizens whose spokesman is President Roosevelt. For the ideas of our President no better background can be found than the economic doctrines of Professor Clark, who has developed the side of economics on which popular beliefs rest into a simple, forceful system which gives a program for action demanded by the feelings and interests of the people. The public is fully convinced that just prices are cost prices and that government should increase its functions and become a regulator of prices.

The public, Professor Clark and the President are also agreed as to the fields where the cost prices are to be introduced. Railroad rates and the tariff are to be modified so that the cost of production shall fix prices. This means a physical valuation of railroads and a similar estimate of the costs which manufacturers must undergo in the United States. There seems to be a ready means of doing this by setting aside the watered stocks of railroads and the lowering of the tariff to a point where monopoly advantage ceases. But the lines between these fields are not so sharp as the President and Professor Clark suppose. Watered stock is a definite sum and in a single field, but watered costs is a general phenomenon. Every one thinks he earns what he gets, but he keeps his accounts in such a way that he exaggerates his costs until they seem equal to his income. As he views it, he has no unearned income similar to the watered stocks of railroads or the high prices of protected industries. But were the principle of physical valuation introduced and the functions of government so extended that it became the controller of prices, his costs would not be estimated by himself, but by others who would have the same interest in reducing them that he now has to do this for the railroads and protected indus-

[2]Essentials of Economics, p. 559.

tries. And we are not without those who demand an extension of the doctrine of physical valuation beyond the point set by Professor Clark and the President. The single tax doctrine applied to land has the same thought as has the physical valuation of railroads. The farmer thinks that land values depend on real costs, and the city land speculator has the same opinion as to town lots; but a public valuation of this property would cause the watered costs of the farms and city property to shrink to a lower point than would the values of railroads.

Professor Clark has a skilful way of hiding land values by subserving them under the general concept of capital, but if the doctrine of physical valuation is once introduced the public will soon be educated to the evils of watered land values, and the same demand will arise for its physical valuation. If the doctrine is correct and the fixing of prices is a duty of the state, the principle will gradually have its application extended until every kind of property is brought under governmental regulation, and no watering of stock or of costs will be allowed.

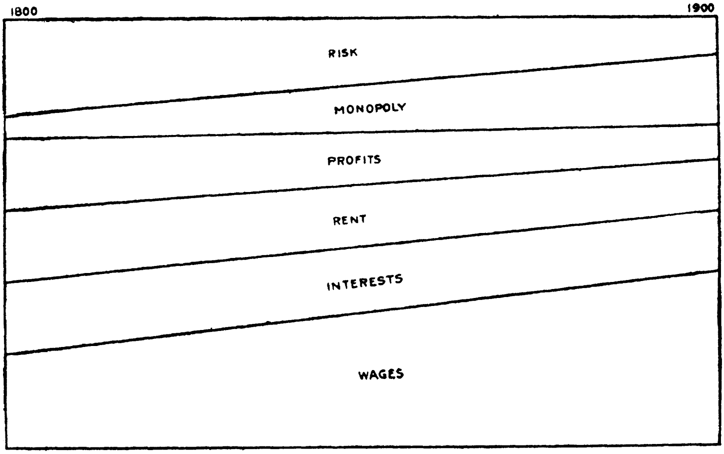
At present there are four classes of property that gain a relatively large share of the benefits of improvements and whose values and costs are most frequently watered. These are the railroads, protected industries, western farms and city land. A city lot valued at $100,000 or a western farm that sells at $100 an acre represents a higher proportion of watered values than do railroad stocks or the protected trusts. The application of the principle of physical valuation to railroads does not mean any advantage to the public so long as the same principle is not applied to farms and city lots. Low railroad rates mean a high value of western farms with higher rents and more congestion of population in eastern cities. Should the value of western farms go up to $150 an acre because of lower rates, it does not mean that western farm laborers will get more wages, or that farm produce will sell at a lower price in eastern cities. Higher land values will push the country population into cities more rapidly than before and the pressure to lower wages will be strengthened. These conditions will make apparent the advantage of extending to land the same principle of physical valuation that landholders now want to have applied to railroad property and to protected industries.

The doctrine of costs prices, the physical valuation of property

and the control of prices by the state cannot but bring on a series of class conflicts in which the minority will suffer at the hands of the majority; for the kinds of property that are in the fewest hands will be those to which this principle will be first applied, and each other kind of property will be attacked in turn until the application of the principle is general. The dilemma of the principle of physical valuation is that a limited application of the principle does not aid the public; it merely lowers the value of one form of monopoly and raises that of some other. Farms go down in value as railroad rates go up. Land values in cities go up as tariffs go down. Some special class gains by the price changes which the introduction of cost prices in other quarters creates. The public gains nothing by these price conflicts, however the state settles them. To permit it to control some prices is to give it the power to favor special interests; on the other hand, if it control all prices the state becomes socialistic.

It is often said that the way to avoid socialism is to control particular prices such as railroad rates or tariff schedules; but this control will not help the public so long as other forms of monopoly remain undisturbed. Partial socialism does not cure socialism, because it does not remove the evils of which the public complains. It merely reduces the rate of progress, and thus, by the stagnation it creates, gives new strength to the demand for more thoroughgoing socialism. The line of cost is the line of bankruptcy, and the state must soon take over any industry or enterprise that must face unexpected costs but cannot retain extra gains. We cannot get free trade through low tariffs, cheap food through low railroad rates, lower house rents by reducing the price of street-car transportation, nor can we get natural low prices through state control of particular industries.

While monopoly cannot be prevented, its amount can be reduced by the increased power of substitution which improvements bring. The gains of monopoly are temporary, due to sudden increases of productive power. But each generation will see its sphere reduced, for the power of substitution constantly works against monopolies, as it works adversely to rent, profits and interest. Wages will gain what these shares lose, and will in each generation form a larger part of the price of commodities. The changes that time brings can be illustrated in a diagram, as follows:



The area of this diagram represents the total price of commodities, while the shares of the various factors are shown by the distances between the lines that divide the area into parts. The changes of the past century can then be pictured by the alterations in the distance between these lines. It shows that wages have steadily increased while rent, profits and interest have fallen off, not in amount, but in the part they play as elements of price. Special monopolies have increased in amount, but not in a way to increase prices, as the element of risk has decreased more rapidly than monopoly has increased. So long as the gains of special monopolies are not larger than the reduction of risk there is no transfer of income to them from any other class.

America is now at the point in its national development where these monopolies are at their maximum. Should a diagram of the price movements of the next century be made similar to the one just given, special monopolies would be a falling share like rent or interest, while wages would continue to rise even more rapidly than in the past. There is no danger of a permanent increase of industrial monopoly. The new forms that arise will displace those now existing as new forms of profits appear with each change in the industrial situation, only to disappear again with the spread of knowledge and efficiency. We can thus work away from a condition of monopoly through the alterations in industrial conditions, but we cannot crush monopoly nor make sudden reductions in its total amount. Public policies to be effective must reach it indirectly

by changes that increase the rate of progress. We cannot afford to check progress in order to test an untried principle in the distribution of wealth.

Thus far improvements in distribution have been effected by the slow diffusion of income and intelligence that follows the general uplift of mankind. Much more is to be gained by a redistribution of population so that the national resources will be better utilized than by any scheme for the forceful alteration of prices, or the redistribution of property. The real remedy for a bad distribution of wealth is more capital to develop our unused resources. We should have double the amount of capital invested in railroads and even more in our industries. The rate of return on capital that secures progress through new investments must be higher than the rate of return that preserves capital.

The redistribution of population following improvements in transportation will eradicate what now seems an evil in distribution, but which in reality has its cause in the present bad location of population and industry. The road to prosperity is not through class conflict, with its mulcting of the minority,—it is rather in social improvements that take men from the margin of production and place them in contact with better resources and in more favorable situations. Civilization is a change in conditions, not an increase in fighting power. It is a movement from conflict to harmony, from a brutalizing environment of individual discords to one of peace, sympathy, and co-operation. The power that moves the race forward is that which brings the feelings and interests of men into accord, which takes men from groups with local conflicting claims, and merges them into a solid, unified nation.

Only general far-reaching changes can give a new environment and free mankind from the depressing restraints that cause misery and poverty. Two plans for the increase of equality are open; either there must be a sacrifice of those having economic advantages in the hope that their loss will be a gain for others less advantageously situated, or there must be social work on the part of those economically favored directed towards a change in the conditions under which the poor live. Both plans have a morality, but one is the primitive morality of sacrifice, while the other is the economic morality of work. Both take income from the well-to-do; the one gives it to the poor to use as they will; the other takes

it to improve external conditions from which all benefit. Primitive justice demands the giving up of all we have for the poor; economic justice consists, not in giving up positions of advantage, but in creating similar positions for other people. It is only the extension of opportunity, the growth of efficiency, the spread of knowledge and the increase of health that can cause poverty to disappear and give a secure income to every family.

A program of social improvement thus demands work rather than sacrifice. Wages should be raised, not by giving income to workers in poor situations, but by moving them to positions of advantage in other localities and industries. Social work consists in moving people from the margin instead of aiding them at the margin. It takes men from places where poverty and disease oppress them and gives them the full advantage of a better position. It gives to the city worker the room, the air, the light and the water that the country worker has, but without his inefficiency and isolation. It gives more working years and more working days in each year, with more zeal and vitality in each working day. Health makes work pleasant, and pleasant work becomes efficient work when the environment stimulates men's powers to the full. Poor land must be made good land; desert land must be made to yield a generous return; the uplands must be turned into forests so as to protect the richer lands of the valleys; the unskilled worker must be transformed into an efficient citizen; the irregular trades into which marginal men flock must be safeguarded so that they will stimulate and elevate the worker instead of lowering his life and vitality. Children must be kept from work and women must have shorter hours and better conditions. Men can thus be moved from the margin and an equality secured through the more generous return which the new situations give. By these means the incomes and personal efforts of those favorably situated can reduce the evils of poverty without the destruction of the advantages upon which their welfare and the progress of society depend.

The nation can gain economic equality by moving forward; it can regain primitive equality by a reassertion of cost standards. A clear perception of this contrast will free the American people from the difficulties of their present situation. We cannot compromise between opposing programs for social betterment. We must do more work for others or suffer severe losses at their hands.